Czech Economic Quarterly

March 18, 2025

Blurry vision

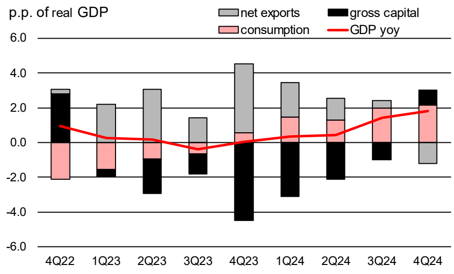
- In 4Q24, real GDP growth accelerated to 0.7% qoq and 1.8% yoy. In yoy terms, growth was mainly driven by private consumption, which accelerated to 3.2%. Fixed capital formation declined by 2.4% yoy. After seven quarters, inventory accumulation turned its growth contribution positive (1.5 pp.). The contribution of net exports was negative (-1.2 pp.), with export and import volumes rising by 1.3% and 3.1% yoy, respectively.
- Based on the published data for January and February, we assess that the Czech economy continues to grow in 1Q25, though its qoq pace has likely slowed compared to 4Q24. For 1Q25, we estimate GDP growth at 0.4% qoq and 1.9% yoy.
- In our baseline scenario, we are revising our GDP growth outlook for 2025 only slightly down to 2.1%, while keeping the 2026 forecast unchanged at 2.4%. However, we recognize a significant increase in risks, most of which point toward economic slowdown scenarios. In addition to previously considered risks, the reliability of the U.S. as a geopolitical ally for Europe is now in question, potentially having numerous negative and hard-to-quantify effects on Czech GDP beyond this year. A potential trade war between the U.S. and Europe represents a separate risk factor. On the upside, Germany's plan for infrastructure and defense investments beyond the existing debt brake is a new positive factor.
- Economic risks, combined with inflation staying within but near the upper bound of the CNB's tolerance band, will call for caution in further rate cuts. We still see the terminal repo rate at 3.25%, though its achievement may be delayed until 1Q26.

REAL GDP (CONSTANT PRICES OF 2015, ADJUSTED)

	4Q24		3Q24 revised	
	YoY change	% of change in GDP*	YoY change	% of change in GDP*
GDP total	**1.8**	**1.8**	**1.4**	**1.4**
Household consumption (%)	3.2	1.5	2.4	1.1
Government consumption (%)	3.2	0.6	4.3	0.8
Fixed capital formation (%)	-2.4	-0.7	-0.8	-0.2
Change in inventories	-	1.5	-	-0.8
Net exports	-	-1.2	-	0.4

Source: Czech Statistical Office. Calculations: UCB CZ.
**/ Real GDP in the same period of previous year*
Remark: The national accounts are based on chain-linked data, which introduces a discrepancy

GDP growth by components of demand*



*/ Contributions to real GDP growth in percentage points
Sources: CZSO, UniCredit Research.

The contribution of consumption to yoy GDP growth in 4Q24 increased due to higher household spending. After four quarters, the contribution of gross capital formation returned to positive values, but solely due to the inventory sell-offs coming to an end. Net exports, on the other hand, slowed overall GDP growth.

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4Q24: GDP Acceleration Driven by Households

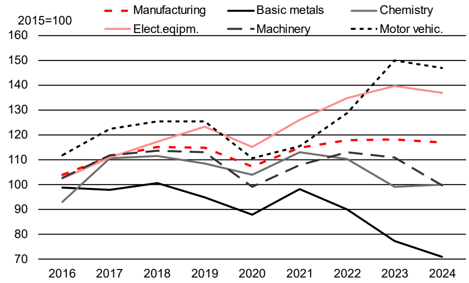
In 4Q24, real GDP growth accelerated to 0.7% qoq and 1.8% yoy. On a yoy basis, growth was primarily supported by private consumption, which accelerated to 3.2%—matching the pace of government consumption, which, in contrast, slowed down. Fixed capital formation declined by 2.4% yoy, with residential investment falling by 2.0% and machinery & equipment investment again dropping by double digits (-10.5%). Spending on intangible capital was also lower yoy (-0.7%). After seven quarters, inventory accumulation turned its growth contribution positive (1.5 pp.). Net exports had a negative contribution (-1.2 pp.), with export and import volumes rising by 1.3% and 3.1% yoy, respectively. The overall export growth was mostly driven by services, while goods exports rose by only 0.6% yoy. Gross value added (GVA) in constant prices increased across all sectors except for industry, where it fell by 2.2%. In nominal terms, GDP was 5.6% higher yoy, with a slight slowdown in the deflator to 3.7%. Total employment increased by 0.2% yoy, while hours worked rose by 0.5%. As a result, productivity grew by 1.6% per worker and 1.3% per hour in real terms. Gross operating surplus and mixed income in current prices were up by 2.1% yoy, while employee compensation rose by 6.7%.

Household consumption likely grew slightly faster than real income, suggesting a correction in the previously extreme savings rate. However, households continued to spend mainly on short-term consumer goods, while their long-term expenditures remained subdued. On the production side, we note the divergence in GVA growth between industry and other sectors. Historically, such situations have been rare and short-lived. We are concerned that if industrial demand does not improve this year, its underperformance could drag down the rest of the economy.

1Q25: GDP Growth Likely Below 2% yoy

In January, the services sector maintained its dominance in GDP growth, with an adjusted output increase of 2.3% yoy, while industry contracted by 0.6%. No leading indicators currently suggest an imminent recovery in industrial production. Industrial orders fell by 1.9% yoy in nominal terms in January. However, exports in January recorded an estimated volume growth of 7–8% yoy. The S&P PMI index rose to 47.7 in February—the highest level in 32 months but still well below the threshold of 50. The construction sector performed well in January, with output rising by 8.2% yoy, though January is not very representative for this sector. Retail sales excluding autos increased by 3.1% yoy in January, while auto sales rose by only 0.7%. From this data, we conclude that the Czech economy continued to grow at the start of the year, though its qoq pace has likely slowed compared to 4Q24. For 1Q25, we estimate GDP growth at 0.4% qoq and 1.9% yoy.

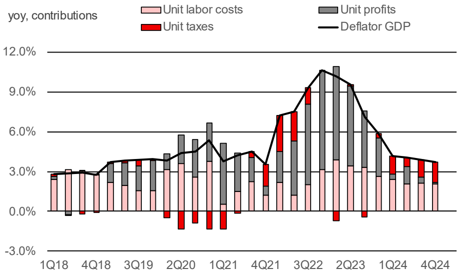
Industrial production in main branches of manufacturing (2015=100)



Sources: CZSO, UniCredit Research.

The year 2024 brought a further widening of the performance gap between industrial sectors. Although the production of motor vehicles and electrical equipment declined slightly compared to 2023, the production of basic metals plummeted. Compared to 2015, car production is now nearly 50% higher, while metal production is 30% lower.

GDP deflator in Czechia by components



Sources: CZSO, UniCredit Research.

The GDP deflator represents a broad and closely watched indicator of price developments in the economy. In Czechia, the deflator reached 3.9% in 2024, with a slight downward trend throughout the year. The chart illustrates the contributions of the three main components to price growth in GDP from the income side. Apart from labor costs, where growth is close to consumer inflation, the low contribution of corporate profits stands out. These were pushed down by rising indirect taxes as part of fiscal consolidation.

2025: Risks Blur the Outlook

We are revising our baseline **GDP forecast for 2025** only slightly down to 2.1%, while keeping the **2026** projection unchanged at 2.4%. However, we recognize a significant increase in downside risks, whose potential impact and timing remain difficult to quantify.

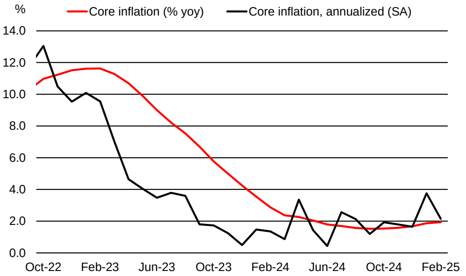
Domestic demand should benefit from the fading impact of previous economic shocks, including the recent inflation wave and fiscal consolidation. Real household incomes are expected to continue growing, driven by only a slight deceleration in **wage growth** to 6.5%, with **average inflation** projected at 2.7%. Total wages will be supported by higher increases in the public sector, while wage dynamics will also reflect a delayed response to past inflation. The labor market, even with **unemployment** slightly above 2024 levels, should not significantly affect household consumption behavior. Meanwhile, the high household savings rate leaves room for consumption growth exceeding real income growth. Our 2.7% estimate for **private consumption** growth this year is therefore viewed as conservative.

In **capital investment**, we anticipate a partial recovery in housing construction and continued infrastructure projects co-financed by the government and EU funds. However, other investment areas remain constrained by geopolitical risks and uncertainties surrounding energy transition goals and their financing. **Fixed capital formation** is set to decline for the second consecutive year (-0.4%) before recovering in 2026. Gross capital formation will, however, be positively impacted by cyclical **inventory restocking** following previous drawdowns. Additionally, increased defense spending under the government's plan could slightly boost investments (and government consumption) starting in 2026.

Foreign trade is likely to slow again from 2Q25 after a temporary volume increase in 1Q25, driven by preemptive stockpiling due to concerns over import tariffs. The extent of the slowdown will depend on the actual scope of tariffs implemented. Regardless, **net exports** will contribute negatively to GDP due to the mentioned inventory buildup.

New risks add to previously identified concerns, including uncertainty about the reliability of the U.S. as a geopolitical ally to Europe. This could have multiple negative, hard-to-quantify impacts on Czech GDP beyond 2025. One likely consequence would be a smaller positive impulse from a potential resolution of Russia's war in Ukraine. On the other hand, Germany's plan to boost infrastructure and defense investments beyond its existing debt brake could serve as a new economic stimulus. If implemented, Germany's additional investments could accelerate Czech GDP growth by 0.2–0.3 percentage points in 2026 (see Focus on page 4). A potential U.S.-EU **trade war** represents another critical risk factor. Broad 25% tariffs could reduce Czech GDP by nearly 1 percentage point, spread over 2025 and 2026, while also driving inflation higher. If U.S. tariffs remain limited to steel and aluminum, as currently the case, the impact on the Czech economy will be barely measurable.

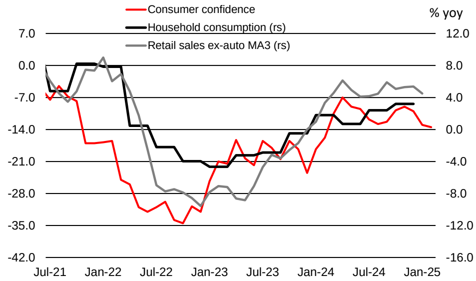
Core inflation in Czechia – year-on-year and month-on-month annualized



Sources: CZSO, UniCredit Research.

Core yoy inflation has shown a slight upward trend in recent months from levels below 2%. Annualized inflation declined in February but paints a very similar picture. The inflationary wave is behind us, but the price stability is starting to be challenged by new risks.

Consumer confidence, retail sales and household consumption



Sources: Macrobond, UniCredit Research.

The pace of real household consumption growth in 4Q24 exceeded 3%, but such a result appears unsustainable in the long run. Consumer confidence in the first two months of 2025 and January retail sales are both pointing to a lower momentum in private consumption.

CNB Policy: Nearing the Bottom of the Rate Cycle

The described economic risks, combined with inflation hovering near the upper limit of the CNB's tolerance band, will necessitate a cautious approach to further rate cuts. We maintain our estimate for the terminal repo rate at 3.25%, though its achievement may be pushed back to 1Q26.

Focus: Can Germany's Fiscal Bazooka Jumpstart the Czech Economy?

The sluggish eurozone economy, particularly Germany, has been a drag on Czech growth in recent years. Despite some successful reorientation of Czech exporters toward non-European markets, the Czech economy remains the most dependent on Germany worldwide, with Austria close behind. Based on global input-output tables for 2020, German final demand (consumption and investment) directly and indirectly accounts for 7.6% of Czech GDP, while Germany's exports to the rest of the world contribute an estimated additional 1.7%. In total, roughly 9.3% of Czech GDP depends on Germany (for comparison: 9.1% for Austria, 8.4% for Hungary, 8.0% for Poland, 6.9% for Slovakia, and only 2.3–2.5% for France, Spain, and Italy). Given that foreign demand accounts for over 39% of the Czech economy, Germany alone represents nearly a quarter of this volume.

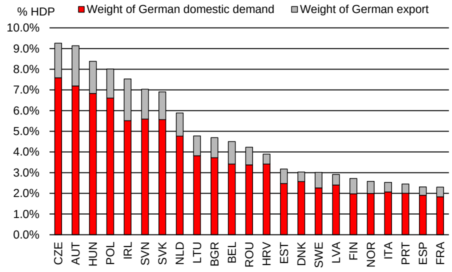
Recent statements from German policymakers suggest plans to ease debt-financing rules and launch an investment boom with a "fiscal bazooka" worth €500 billion (11.6% of German GDP). Additionally, Germany aims to rapidly increase defense spending from 1.8% to around 3% of GDP. If implemented, this could once again make Czech dependence on Germany beneficial. Although the plan is still under political negotiation, it is likely to be approved.

If infrastructure investments were spread over ten years and defense spending increased to 3% of GDP as early as next year, this would generate a fiscal stimulus of €100 billion—equivalent to approximately 2.4% of German GDP or 3.3% of German domestic demand. Given the Czech economy's exposure to Germany, along with additional multiplier effects, this could translate into an additional 0.3 percentage point boost to Czech GDP. While not a game-changer, this would help offset nearly half of the impact of potential U.S. 25% tariffs.

Beyond the immediate impact, this fiscal stimulus could also yield long-term benefits by increasing Germany's economic potential. Moreover, if Germany embarks on a debt-financed investment boom, other struggling European economies may follow suit. This could lead to a period of stronger economic growth, albeit with higher inflation and interest rates than previously anticipated.

A key risk remains that a fiscal package of this scale will attract pressure from various interest groups. Hopefully, spending will be directed effectively to strengthen Europe comprehensively amid threats of war.

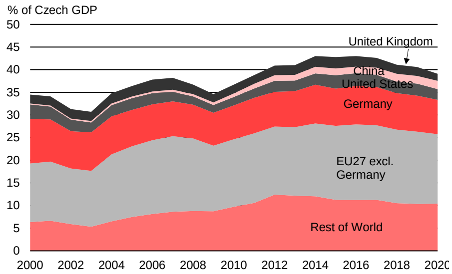
Weight of Germany's demand and export in countries' GDP



Sources: OECD's TIVA (capturing the year of 2020), UniCredit Research

The impact of German final demand (consumption + investment) directly and indirectly accounts for 7.6% of Czech GDP. German exports to the rest of the world contribute an estimated additional 1.7%. In total, 9.3% of Czech GDP is linked to Germany, the highest dependency among all countries worldwide.

Decomposition of foreign demand and its weight in Czech GDP



Sources: OECD's TIVA (capturing the year of 2020), UniCredit Research

The importance of foreign demand in Czech GDP peaked between 2014 and 2016, when 43% of the country's generated value-added was exported abroad. Since then, the share has started to decline, and the latest available data from the global input-output tables for 2020 show a figure of 39.1%. At that time, 59% of total exported value-added ended up in the EU (19% in Germany alone), 6% in the USA, 5% in China, and 4% in the United Kingdom. The remaining 27% was distributed elsewhere in the world.

Macroeconomic outlook for Czechia

	2022	2023	2024	2025 forecast	2026 forecast
GDP growth (real yoy change, %)	2.9	0.1	1.0	2.1	2.4
Household consumption (real yoy change, %)	0.5	-2.7	2.1	2.7	2.4
Gross fixed capital formation (real yoy change, %)	6.3	2.7	-1.3	-0.4	3.0
Industrial output (real yoy change, %)	2.1	-0.8	-0.9	0.5	3.0
Unemployment rate (average, %)	3.4	3.6	3.8	4.1	4.0
Inflation rate (CPI yoy change, average, %)	15.1	10.7	2.4	2.7	2.3
Average wages (nominal yoy change, %)	4.3	8.0	7.1	6.5	5.4
Interest rates (3-M PRIBOR, end of period, %)	7.26	6.97	3.91	3.45	3.35
Interest rates (3-M PRIBOR, average, %)	6.28	7.13	4.98	3.58	3.36
EUR/CZK exchange rate (end of period)	24.12	24.73	25.19	24.80	24.80
EUR/CZK exchange rate (average)	24.57	24.01	25.12	24.90	24.80
Current account balance (% of GDP)	-4.7	-0.1	1.8	2.1	1.9
FDI net inflow (% of GDP)	1.2	1.0	0.5	0.6	0.7
General government balance (% of GDP)*	-3.1	-3.8	-2.8e	-2.7	-2.7
Public debt (% of GDP)	42.5	42.4	43.2e	43.5	44.3

Remarks:
**/ ESA 2010 definition, e/ estimate*
Sources: Czech National Bank, Czech Statistical Office.
Forecasts: UniCredit Bank CZ+SK.